



Technical Information Release

Commonwealth of Massachusetts

Department of Revenue

TIR 99-23 **The Effect of** **Recent Federal** **Tax Law Changes** **on Qualified** **Transportation** **Fringe Benefits** **and the** **Self-Employed** **Health Insurance** **Deduction**

In general, the Massachusetts personal income tax relies on the definitions found in the Internal Revenue Code ("the Code" or "IRC") as amended on January 1, 1998, and in effect for the taxable year, in determining Massachusetts gross income. Since January 1, 1998, Code provisions have changed regarding the exclusion from federal gross income of qualified transportation fringe benefits and the deduction for self-employed health insurance expenses. This Technical Information Release describes these Code changes and their effect on the Massachusetts personal income tax.

A. Qualified Transportation Fringe Benefits — IRC § 132(f)

Massachusetts follows IRC § 132(f) as amended and in effect on January 1, 1998. Section 132(f) excludes from an employee's gross income (subject to a monthly maximum) employer-provided parking, transit passes and employer-provided vanpool benefits. However, two federal Acts subsequent to January 1, 1998, have created differences between the Massachusetts and federal treatment of this exclusion.

The 1999 Exclusion Amounts Are Higher for Massachusetts

Federally, a new inflation adjustment formula has been enacted which will increase the exclusion maximums starting in the 2000 tax year. Massachusetts does not adopt the new inflation adjustment formula. However, for the 1999 tax year the federal exclusion maximums have been frozen at the 1998 levels (\$175 per month for employer-provided parking and \$65 per month for vanpool and transit pass benefits combined). IRC § 132(f)(2), as amended by P.L. 105-178, *Transportation Equity Act for the 21st Century*, enacted on June 6, 1998 ("P.L. 105-178"). In contrast, Massachusetts will follow the inflation adjustment formula allowed under the January 1, 1998 Code, and increase these amounts to \$180 and \$70, respectively, for the 1999 tax year. IRC § 132(f)(2),(6).

Massachusetts Will Not Allow the Exclusion for Transit Pass and Employer-Provided Vanpool Benefits as a Reduction in Salary

Federally, an employer can provide transit pass and employer-provided vanpool benefits under either of two methods. Either the employer can give the benefit to the employee *in addition* to their salary or the employer can offer the benefit to the employee *as a reduction* in salary. IRC § 132(f)(4), as amended by P.L. 105-178. If the employer offers the benefit as a reduction in salary and the employee chooses the benefit in lieu of salary, the employee's federal gross income is reduced by the amount of the benefit, subject to the monthly maximum.

Massachusetts does not adopt the federal gross income exclusion for transit pass and employer-provided vanpool benefits if the employer offers the benefit as a reduction in salary and the employee chooses the benefit in lieu of salary. The federal provision allowing the choice of salary or transit pass and employer-provided vanpool benefits was enacted on June 6, 1998, and therefore, is not incorporated into the Code as amended and in effect on January 1, 1998.¹ As a result, if an employee's salary and federal gross income has been reduced by a transit pass or employer-provided vanpool benefit, the employer must add back the exclusion amount (in the employee's W-2) for Massachusetts tax purposes.

Massachusetts Withholding is Not Required

The definition of "wages" for Massachusetts personal income tax withholding purposes adopts the definition of wages in section 3401(a) of the IRC as amended and in effect for the applicable tax year. G.L. c. 62B, § 1. Therefore, Massachusetts automatically adopts changes to IRC § 3401(a) for withholding purposes. Benefits excluded from an employee's gross income under IRC § 132 are excluded

1. This same choice of salary versus benefit is allowed for employer-provided parking. Massachusetts allows this choice for parking because the federal provision for parking was enacted **before** January 1, 1998. See Technical Information Release 98-15, *The Effect of the Adoption of the Updated Internal Revenue Code on the Massachusetts Personal Income Tax* ("Code Update").

**Department of Revenue
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Transportation Fringe
Benefits and the
Self-Employed Health
Insurance Deduction**

from the definition of "wages" under IRC § 3401(a)(19). As a result, they are not subject to Massachusetts withholding, even if, as in the case of certain transit pass and employer-provided vanpool benefits, the benefits are subject to the Massachusetts personal income tax.

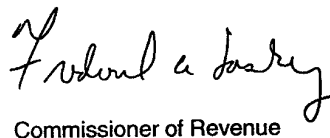
However, individual taxpayers may want to request that their employers withhold additional Massachusetts tax from their salaries to cover taxes on income which is not subject to Massachusetts withholding. Taxpayers who have not paid at least 80% of their tax liability through Massachusetts estimated payments or withholding are, with certain exceptions,² liable for an addition to tax. G.L. c. 62B, §14.

B. Self-Employed Health Insurance Deduction — IRC § 162(l)

Massachusetts adopts the federal deduction for amounts paid for medical care insurance for the taxpayer and his or her spouse and dependents. IRC § 162(l). The deduction gradually increases each tax year until it reaches 100% of the amount paid for medical care insurance. Federally, a provision that accelerated the schedule for increases was enacted on October 21, 1998, effective for 1999 tax years. P. L. 105-277, *Tax and Trade Relief Extension Act of 1998*. Under this new accelerated schedule for increases, the federal deduction will be 60% for the 1999 tax year.

Massachusetts adopts the January 1, 1998 Code, which incorporates a different schedule for increasing the self-employed health insurance deduction. As a result, Massachusetts will allow a deduction equal to 45% of the qualified insurance payments for the 1999 tax year. IRC § 162(l)(1)(B).

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Commissioner of Revenue

2. See G.L. c. 62C, §§ 13, 14 and Administrative Procedure 241.4, for information regarding exceptions and waivers to the addition to tax.